

*Testimony of*

**James E. Smith**

*On Behalf of the*

AMERICAN **BANKERS** ASSOCIATION

Before the

**Subcommittee on Financial Institutions and Consumer Credit**

of the

Committee on Financial Services

United States House of Representatives

July 24, 2002



Testimony of James E. Smith  
On Behalf of the American Bankers Association  
Before the  
Subcommittee on Financial Institutions and Consumer Credit  
of the  
Committee on Financial Services  
United States House of Representatives  
July 24, 2002

Mr. Chairman, I am James E. Smith, Chairman and CEO of Citizens Union State Bank and Trust, Clinton, Missouri and the President of the American Bankers Association. I am pleased to be here today on behalf of the American Bankers Association (ABA). ABA brings together all elements of the banking community to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional, and money center banks and holding companies, as well as savings institutions, trust companies, and savings banks – makes ABA the largest banking trade association in the country.

I want to thank you, Mr. Chairman, for holding this hearing. It allows all parties to get beyond the heated rhetoric and focus on the issues. In the debate over allowing banks to engage in real estate brokerage, we bankers have sometimes been portrayed as working against real estate agents. We disagree with this characterization. The reality is that many agents and bankers already work closely with one another. In fact, I believe that bankers and many in the real estate industry are much closer aligned on the issue of real estate brokerage than the rhetoric suggests. We all believe that customers deserve to have the best possible service, regardless of what company provides it. We all want customers to have many choices so they can seek out that agent or company that they trust. And we all believe that the provision of any financial service should be done in a safe and sound manner – including adhering to all licensing, qualification, sales practices, and continuing education requirements.

If banking institutions offer real estate brokerage and management services consumers would have more choices of real estate firms when buying or selling a home. Real estate agents would have more choices of potential employers. And real estate companies would have more choices of firms to partner with that could provide new sources of capital and technology. By prohibiting bank involvement, H.R. 3424 would do just the opposite – consumers, real estate agents and real estate companies would have **fewer** choices. We believe a competitive market is the best way to provide quality real estate brokerage and management services.

As we begin our discussion, it is important to note that combining real estate brokerage and banking services is not a new or unusual activity. Real estate firms do it. Insurance companies do it. Securities firms do it. And well over half the federally insured depository institutions in this country, including many of the largest banks and savings institutions, have authority to do it.

In fact, my community bank in Missouri has the authority to do it and has for many years. Like most banks that could provide real estate services today, I have yet to move into this line of business; but I am rethinking our bank's strategy on this matter. I have to. Even in my small town of Clinton, with 9,600 residents, it is obvious that the world is changing rapidly. I am losing customers to local real estate firms that are aggressively offering mortgages and homeowners' insurance. Since the customer often goes to the real estate firm first, I lose out on the ability to offer those products – and the customer also misses out on the opportunity to have another choice.

And the choices are getting fewer and fewer as aggressive national real estate firms like Cendant (which owns Century 21, Coldwell Banker, and ERA) and RE/MAX gobble up small locally-owned real estate firms. These two firms already control nearly a third of all real estate transactions. Cendant's real estate subsidiary, NRT, **has averaged about one acquisition per week since 1997**. In my small town of Clinton, it is RE/MAX that has bought up the largest of the three real estate firms. Its marketing and financial backing, and its mortgage lending and insurance operations, are certainly much bigger than mine. The number two real estate firm seems to be doing well and probably can compete effectively – although, given the rapid consolidation in the real estate brokerage business, it might sell out as well.

However, I believe the third, the smallest agency, may be struggling to compete. I wonder if it has the marketing and financial resources to compete with RE/MAX. What are its choices? Continue to struggle? Go out of business? Sell out to Cendant or another large chain? Would it not be better for it, and for my community, if it could partner with my bank in some fashion, stay in business, and provide locally owned service? How is the National Association of Realtors (NAR) helping that real estate agency or my community by working to preclude such an option?

While I am at it, I would like to comment on community involvement and investment since NAR has raised it in its lobbying campaign. My town is probably typical. Like many others, it is struggling to maintain a vibrant downtown, although many businesses have moved out to the highway malls. My bank has made low interest loans to support downtown development and business, and we have kept our offices downtown. Where are the realtors? They have moved out to the highway.

My experience is not unique. My colleagues who run small community financial institutions also believe that bank provision of real estate services would significantly benefit their customers and communities. In fact, the ability to offer real estate brokerage may be more important for smaller institutions. Rural communities may lack real estate agents or are served only by branches of brokers in other towns because there is insufficient business to warrant a local brokerage office. In such small communities, the bank is perceived as the place that has the greatest amount of information on what properties are for sale, including farmland acreage in agricultural communities.

This issue of open and fair competition is not new – in fact, it has been debated in this legislative body for many years. However, the statutory context within which today's discussion will take place is quite different. In 1999, Congress took an historic step to modernize the regulation of the financial services sector by passing the Gramm-Leach-Bliley Act (GLB Act). In the 20 years of debate on the Act, Congress often found itself in the middle of arguments between financial services industries about who should do what. The result was gridlock and an out-of-date financial system that did not reflect changes in consumer needs or in the use of technology.

To be sure that the pro-competitive goals of the GLB Act continued to be met in a dynamic marketplace, Congress established a flexible, yet conservative regulatory process that would permit the financial industry to offer new services without the need for further legislation. This regulatory system gives the Federal Reserve and Treasury the *flexibility and responsibility* to determine what activities should be approved, including considering what is necessary to permit financial holding companies and national bank subsidiaries to “compete effectively with any company seeking to provide financial services in the U.S.” This authority is consistent with the Federal Reserve’s and Treasury’s role to ensure efficient, safe, and competitive financial markets.

Those involved in the debate over the many years that led up to the GLB Act should not have been surprised to see the current proposal to allow banks to offer real estate brokerage and management services. Over a decade ago, the ABA and the NAR negotiated the rules under which banks would enter the real estate brokerage business. This negotiation was in the context of an early version of the GLB Act which was much more restrictive than the criteria enacted in 1999. Thus, over ten years ago, the NAR recognized that even a more restrictive version of financial modernization could be interpreted as permitting banking companies to offer real estate brokerage services. Furthermore, in 1995, NAR testified on yet another more restrictive forerunner of the GLB Act before the House Banking Committee. In that testimony, NAR stated unequivocally that the language must be clarified to exclude brokerage and management. ***It was not clarified then, nor was it clarified in the GLB Act.*** Certainly the NAR had every opportunity to raise the issue with Congress in 1999 and either chose not to or did so without success.

The GLB Act is a solid, well thought out piece of legislation. It promotes competition and safety and soundness, and enables Congress to avoid becoming embroiled in every competitive issue. H.R. 3424 would put Congress back in as referee for future competitive disputes and would reverse the most important long-term provision in the GLB Act. Having worked so hard to develop a mechanism to continually keep our financial system up-to-date, Congress should not reverse itself less than three years later because one particular group wishes to protect itself from competition. The system established in the GLB Act should be allowed to work and H.R. 3424 should not be enacted.

Simply put, banking institutions should be allowed to offer real estate brokerage and management services for three key reasons:

- ***It's good for consumers*** – It means more choices, better service, competitive prices and greater convenience.
- ***It's only fair*** – Since real estate firms offer banking and insurance services, it's only fair that banking institutions be allowed to provide real estate services. This is what the Gramm-Leach-Bliley Act is all about – promoting free and fair competition by leveling the playing field.
- ***It's safe*** – All consumer protections, ***including all state licensing, qualification, sales practices, and continuing education requirements, plus strict privacy laws and anti-tying rules***, would apply to bank-affiliated real estate agents. And because brokerage and management are agency activities, they pose no risk to the bank.

I will discuss these points in detail in the remainder of my statement.

## **I. Competition Benefits Consumers**

The benefits of competition are well known. In a free market, businesses choose to offer new products if they believe they can provide better services at competitive prices. Obviously, not all banking organizations will choose to offer real estate services, but those that do will enter the market because they believe they can meet or beat the competition. Increasing the number of providers raises the bar for all the participants, forcing improvements in efficiency, pricing and service levels – ***all to the benefit of homebuyers and sellers.***

Allowing all banking institutions to provide real estate services expands the choices for everyone: consumers, real estate agents and real estate companies.

### ***More Choices for Consumers***

More players in the real estate business mean more and better products for consumers. In any competitive market, new participants bring new, creative ideas to the market – all designed to provide better service and greater convenience, at reasonable prices. In fact, businesses can only be successful in new markets by providing services that meet the needs of customers. Free competition among a wide variety of providers is the cornerstone of our economic system.

### ***More Choices for Real Estate Agents***

Real estate agents pride themselves on being independent contractors, choosing the best companies to work for. If there are more companies to choose from, agents' employment opportunities will be much broader. Banks will only be able to attract good agents by offering competitive commissions and other incentive-based compensation packages. And because the real estate business requires expertise, licensing, and other requirements, banks would seek out experienced real estate agents.

### ***More Choices for Real Estate Companies***

Forward-looking businesses are always looking for opportunities to improve their franchise value – strengthening, expanding, merging, or even selling their business. Allowing banking institutions to engage in real estate brokerage and management services gives real estate companies more options for bringing additional capital and technology to the table, through joint ventures, for example. Banking institutions also represent potential buyers if agencies choose to sell their businesses. Indeed, in some communities, partnering with the local bank may be the only way for the local real estate broker to compete with the growing national chains.

This is why many real estate firms also oppose S. 1839. For example, in February of this year, ***the Realty Alliance – comprised of many of the nation's largest and most successful independent real estate companies with a total of 62,000 agents – went on record in opposition to NAR's position.*** In its letter to NAR, The Realty Alliance stated:

Our members favor and support a fair, free-market environment unbound by legislative restrictions. We find it hypocritical and fundamentally wrong to ask that national bank subsidiaries be barred from real estate brokerage activity, while real estate brokerages operate mortgage banking, insurance and title insurance businesses.... We believe, in fact, that consumers would benefit from the influx of capital that may result from nationally chartered banks entering this arena. We also believe that increased competition from companies of size would benefit consumers by making all of us sharpen our skills and improve the services we provide. In our view, the role of government is not to limit competition, as your legislation would do, but rather to foster a business environment in which consumers benefit from competition. The members of The Realty Alliance look forward to working, and prospering, in such an environment.

The Real Estate Services Providers Council (RESPRO) also supports bank entry into the real estate brokerage business. RESPRO is a national non-profit trade association comprised of real estate broker-owners, real estate franchisers, mortgage lenders/brokers, and other settlement service providers throughout North America. Its members engaged in real estate brokerage closed over one million residential real estate transactions in 2001 with over 300,000 sales associates, 78,000 employees and 50,000 offices. In recent letters to Members of Congress, the Federal Reserve and the Treasury Department expressing support for the proposed rule, RESRPO noted:

RESPRO strongly believes that all providers should be able to offer consumers the benefits associated with realty-based one-stop shopping, in an open and competitive environment. Our research shows that a number of financial conglomerates (e.g., Sears, Merrill Lynch, GMAC, Cendant), state-chartered banks, and savings banks have entered the real estate brokerage business, with varying degrees of success. Their presence in the real estate marketplace has not changed the basic character of the real estate brokerage business. In fact, we believe their entry has contributed to the development of a wider range of services and has caused traditional real estate brokerage firms to become more efficient and more consumer-focused than they were before.

It is interesting to note that many insurance agencies thought that bank involvement was going to hurt their business – until they realized that it provided many more options than they had before. We now have a great deal of experience in banks and agents working together under the rules of the GLB Act. The agents have found this to be a very positive experience.



Simply put, H.R. 3424 reduces choices: consumers would have fewer choices of whom to do business with, agents would have fewer choices of whom to work for, and businesses would have fewer choices for joint marketing, fewer potential merger partners, and fewer potential buyers. ABA believes a competitive market is the best way to provide quality real estate brokerage and management services – more competition means more choices.

## **II. Gramm-Leach-Bliley Act: Flexibility to Adapt to an Evolving Marketplace**

The Gramm-Leach-Bliley Act established a framework for keeping our financial system up to date. After working on this for the last 20 years, Congress recognized the need for flexibility in the face of a rapidly evolving financial landscape. As Senator Phil Gramm said at the signing ceremony for this Act: “The world changes, and Congress and the laws have to change with it....We have learned that we promote economic growth and we promote stability by having competition and freedom.”

Providing the same opportunities under the same rules and regulations is a key to promoting free and fair competition. In today’s real estate market, it is commonplace for real estate companies, securities firms and insurance companies to provide end-to-end services, including brokerage, mortgages, and insurance. We believe this combination of services is good for consumers. Yet not all financial service players have equal ability to offer these options. The Gramm-Leach-Bliley Act was designed to address these inequalities.

To examine this in detail, this section looks at three key issues:

- The marketplace reality that real estate firms are already providing banking and other financial services;
- The flexibility established in the Gramm-Leach-Bliley Act to correct disparity in the provision of financial services among providers and thereby promote free and fair

competition; and

- The changing real estate and financial marketplace that demands a flexible regulatory approach to address inequities that exist today and may exist in the future.

### ***Marketplace Reality: Real Estate Firms Already Provide Banking Services***

As I noted at the outset, combining real estate brokerage and banking services is not a new or unusual activity. Real estate companies, securities firms, insurance companies, credit unions, savings associations and, in half the states, state-chartered banks can offer real estate services.<sup>1</sup> Ironically, the National Association of Realtors is now objecting to the very combinations that their members have undertaken – offering brokerage, mortgage banking, and, often, insurance under one roof.

Take, for example, two of the biggest real estate companies in the Washington D.C. area – Weichert and Long & Foster. Both offer the full range of financial services. Weichert calls it “One Stop Gold” and Long & Foster calls it “Real-Edge Services.” In the following pages, I have included several examples of how real estate companies that offer both banking and brokerage services characterize – in their words – their services. One example is from GMAC – the GM standing for General Motors. This is one of the largest real estate companies in the country.

These examples show the importance real estate companies – and their customers – place on having the option to combine real estate brokerage, mortgage and insurance services. These combinations of services are good for consumers, providing them with lower costs, greater convenience and more service options. The ABA believes that all banks should have the same opportunities to meet the needs of our customers. In fact, according to NAR’s own survey in 1999 and a recent 2002 survey by Murray Consulting, not only is one-stop shopping viewed very positively by homebuyers, but banks, mortgage companies and real estate companies are all viewed ***equally*** as appropriate providers of these services.<sup>2</sup>

---

<sup>1</sup> See attachment developed by the Conference of State Bank Supervisors (CSBS) for a listing of the authorities for each state. Regarding credit unions, recently several credit unions in Wisconsin jointly purchased a majority interest in one of the state’s larger real estate brokerage firms

<sup>2</sup> Murray Consulting, *Consumer Perspectives on Realty-Based One-Stop Shopping*, April 2002

Simply put, if real estate services and other financial products are already combined by many real estate and other financial firms, there is no reason why all banking organizations should not be accorded the same opportunities to provide these products to their customers.

Not only is it true that real estate firms already provide end-to-end services, it is also true that the largest real estate companies have been increasing their domination over the market. In 1990 there were 150,000 residential real estate firms. Today there are about half that many. The large chains are buying up more and more local firms. In fact, Cendant's subsidiary, NRT, states on its website:

Since its inception in 1997, NRT has spurred its tremendous growth through a non-stop series of strategic acquisitions and mergers. We are constantly seeking to enhance our success by acquiring strong players in each of our local markets – and expanding into new markets – and supporting them with whatever resources they need. NRT has proven itself to be a company committed to action, acquiring nearly 50 companies annually in the first four years of existence.

The table on the next page shows the top 50 acquisitions by Cendant's NRT with a combined yearly sales volume of \$85 billion. Its most recent acquisition was Arvida, the largest realty firm in Florida.

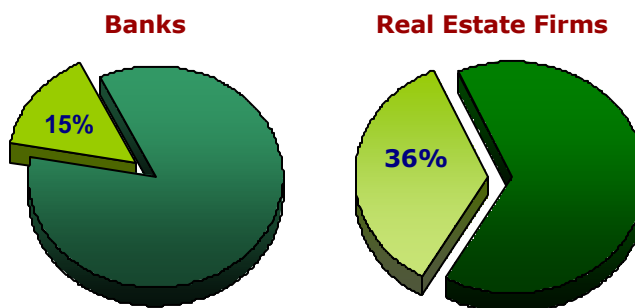
With such aggressive acquisitions, it is no surprise that the real estate industry is increasingly concentrated (see Chart 1).

In fact, the top **three** firms in the brokerage business (Cendant, RE/MAX, and Prudential Real Estate) control 36 percent of the market. By comparison, the top **ten** banks have 33 percent of the banking market. Cendant Corporation accounts for 1 out of every 4 real estate agents and alone has a 21 percent market share of existing home sales.

Chart 1

### The Real Estate Industry is Much More Concentrated than the Banking Industry

■ 2001 Market Share of Top Three Firms



And because consolidation within the real estate industry is occurring at breakneck speed, small realty companies are far more likely to be bought up by one of the major real estate firms than by a bank. Many real estate brokers have told the ABA that they would welcome approval of the proposal because it would provide a potential local partner to help them compete with the large national chains. In fact, the local bank can help the small firm, through joint ventures and providing capital, to compete with the large national real estate firms.

With a more concentrated market than banking, it is ironic – and untrue – that NAR claims that only large banks are interested in real estate powers and will come to dominate the market. In my opening remarks I made the point that this is an issue for banks of all sizes, not just large banks. More than 40 percent of all banks – over 4,000 institutions – have fewer than 25 employees. These are small businesses by any definition and they would like the opportunity to broaden the financial products they can offer their customers and to compete with real estate firms offering loans and homeowners insurance.





# Long & Foster—More Than A Great Real Estate Company.

## We're Also A Great Mortgage, Title, And Insurance Company, Too!

Since 1968, the LONG & FOSTER COMPANIES have grown to become the largest and most respected real estate company throughout our five-state Mid-Atlantic region, with annual sales of \$13.3 billion.

We've also become quite a powerhouse in mortgages, title, and insurance, too.

Imagine the convenience of buying a home, securing the mortgage, arranging the title work, and getting homeowners' insurance—all in one place!

That's precisely what the LONG & FOSTER COMPANIES do for their clients and customers: deliver top-quality real estate and related financial services—all in one place—from a name synonymous with customer satisfaction and trust.

Convenience costs no more with the LONG & FOSTER COMPANIES. In fact, it could cost you much less.

Rely on your professional Long & Foster Sales Associate to put you in touch with the other members of the LONG & FOSTER COMPANIES family, whose expertise in mortgages, title, and insurance fully complements that of our expert REALTORS®.



**LONG & FOSTER,  
REALTORS®**



**PROSPERITY  
MORTGAGE  
COMPANY**



**MID-STATES  
TITLE INSURANCE  
AGENCY, INC.**



**LONG & FOSTER  
INSURANCE  
AGENCY, INC.**

**Real-Edge Services,  
All in One Place.™**





**The largest independent real estate broker in Illinois, with more than \$4 billion in annual sales.**

The nation's oldest real estate company actually started in the **financial arena** nearly 150 years ago, when Baird & Warner began making loans on downtown Chicago properties. We continue to play a dominant role today, with Key Mortgage Services and its subsidiary, North Shore Mortgage, closing more than **\$500 million per year in residential mortgage loans — ranking among the top five mortgage companies** in Illinois. Baird & Warner is once again leading the field, offering the **convenience of “one-stop shopping”** for a wide variety of real estate-related services.

Emphasis added

Source: <http://www.bairdwarner.com/about/default.asp>

---



**The nation's largest individually owned real estate company, with over 370 loan products to choose from, including Conventional, FHA, and VA loans.**

Weichert Financial Services' Weichert Gold Services Program is raising the performance guarantee from \$250 to \$1,000 for all new Gold Services applications. If Weichert Gold Services fails to meet its performance guarantees, the homebuyer will receive a \$1,000 credit towards their mortgage related costs at the time of settlement.\*

**\*To participate, the buyer must elect to use Weichert Financial Services to obtain a mortgage, Weichert Insurance Agency to obtain homeowners insurance and Weichert Title Agency or Weichert Closing Services to obtain title insurance.**

Emphasis added

Source: <http://www.weichert.com/>

## *Cendant's NRT Top 50 Acquisitions*

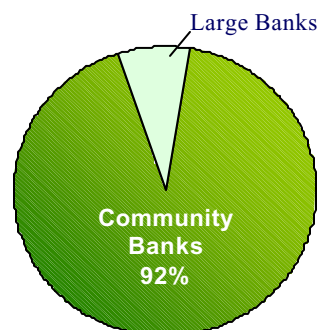
*Over \$85 billion in Yearly Sales Volume*

On July 18, 2002, Cendant Corp., released its second quarter earnings report, which stated that the company's revenues were up from \$474 in 2001 to \$1,440 in 2002. Impressive growth. The explanation was, "Revenues and adjusted EBITDA increased primarily due to the acquisition of NRT Incorporated in April 2002 and increased franchise fees from our Century 21, Coldwell Banker and ERA franchise brands." While NRT had already begun its affiliation with Cendant, this is the first quarter in which the massive presence of these two firms was illustrated by a consolidated balance sheet.

Jon Douglas Company – CA	\$10,500	King Thompson Realtors – OH	\$1,000
Arvida Realty Services – FL	\$7,700	Mansell and Associates – Salt Lake City	\$1,000
Burnet Financial Group – MN, Chicago	\$6,700	Coast Newport Properties – CA	\$950
Fred Sands Realtors, So. CA	\$5,000	William Rigg Realtors – Dallas	\$935
Hunneman Real Estate Corp. – Boston	\$3,700	Coldwell Banker Stanmeyer – Chicago	\$900
Gundaker Realtors – St. Louis, MO	\$3,350	Joseph J. Murphy Realty – No. NJ	\$750
Cornish & Carey Residential RE – CA	\$3,300	Federated Realty Group – Milwaukee	\$700
Coldwell Banker Stevens, D.C., Baltimore	\$2,800	Perry & Butler Realty – Denver	\$700
O'Connor, Piper & Flynn – MD, PA, DE, WV	\$2,800	Jack Gaughen – Harrisburg, PA	\$688
Contempo Realty Bay – CA	\$2,400	Coldwell Banker Premier Realty – UT	\$687
Northside Realty – Atlanta	\$2,250	Kahn Realty – Chicago	\$678
The Corcoran Group – New York, NY	\$2,200	Podley Doan – Pasadena, CA	\$650
Henry S. Miller Realtors – Dallas	\$1,750	Seville Properties – Bay Area, CA	\$630
Coldwell Banker Paula Stringer – Dallas	\$1,700	Coldwell Banker 1 <sup>st</sup> American – IL, IN	\$575
Burgdorff Realtors – NJ	\$1,500	Marie Powell & Associates – Tampa, FL	\$535
Moore and Company – Denver	\$1,500	Coker & Cook Real Estate – Sacramento	\$518
Pardoe RE and Pardoe & Graham – D.C.	\$1,500	The Condo Store – Atlanta	\$400
Buckhead Brokers – Atlanta	\$1,300	TAM-BAY Realty – Tampa, FL	\$399
Gimelstob Realty – FL	\$1,300	Higgins & Heath – Orlando, FL	\$380
Wardley Corporation – Salt Lake City	\$1,300	Del Monte Realty – Bay Area, CA	\$350
West Shell – Cincinnati	\$1,300	Polley Polley Madsen – Sonoma, CA	\$340
Frontier Real Estate – Denver	\$1,200	Waterside Property Sales – Sarasota, FL	\$340
Dyson & Dyson RE Assoc. – San Diego	\$1,100	Coldwell Banker Grand Traditions – OH	\$301
Pacific Preferred Properties Inc. – CA, NV	\$1,090	Metro Real Estate Services – Pittsburgh	\$275
Van Schaack – Denver	\$1,000	John M. Grubb Realty – Bay Area, CA	\$240

It is also a misconception that all national banks are large (see Chart 2). In fact, over ninety percent of national banks are community banks. Moreover, of the 10 largest banking firms, four appear to already have the legal authority to engage in real estate activities. There certainly has been no market disruption from the fact that well over half of the insured depository institutions in this country have the ability to offer real estate brokerage and management services today.

**Chart 2**  
**Over Ninety Percent of National Banks are Community Banks\***



\* Defined as banks with less than \$1 billion in assets

Banks that already offer real estate services through the trust department frequently find themselves having to explain to customers that the bank cannot help them with these services outside the trust relationship. These customers do not understand why the bank is unable to do so. Authority to offer real estate services by the banking organization would bridge this unnecessary gap.

### ***The GLB Act Was Designed to Allow Flexibility to Adjust to the Marketplace***

In the years immediately preceding passage of the GLB Act, Congress recognized that the statutory standard for regulatory approval of new activities for bank holding companies — the “closely related to banking” standard — was woefully inadequate in an economy transformed by technological progress. Thus, Congress agreed to a new, considerably broader, standard to enable banks and bank holding companies to remain competitive no matter in what direction financial services evolved. That new standard — activities that are financial in nature or incidental to a financial activity — was intended to provide the flexibility Congress knew would be necessary. Those activities may be conducted only in financial holding companies (“FHC”) or financial



subsidiaries meeting certain safety and soundness and community needs standards enumerated in the statute.

Congress did not give the FRB and the Treasury unfettered discretion to make the determination that an activity is appropriate for approval. The GLB Act specifically sets forth certain traditional banking activities that Congress knew were clearly financial in nature.

In addition to these currently-recognized activities, the Act authorizes activities that the FRB and Treasury determine, by regulation or order, to be “financial in nature or incidental to such financial activity.” This authority to permit new financial activities is considerably broader than the FRB’s comparable authority before the GLB Act was enacted, which had only extended to a new activity that was “so closely related to banking as to be a proper incident thereto.”

One specific aspect of this new authority is that the FRB is directed to define the extent to which three types of activities are “financial in nature”: (1) lending, exchanging, and engaging in certain other transactions with financial assets other than money or securities; (2) providing any device or instrumentality for transferring money or other financial assets; or (3) arranging, effecting, or facilitating financial transactions for the account of third parties. ABA believes the proposed real estate activities qualify under the first and third statutory categories. For example, real estate brokerage is generally the business of negotiating a contract for the purchase, sale, exchange, lease, or rental of real estate – which we believe is a financial asset – for others.

That real estate is a financial asset cannot be questioned. It is clearly the most important financial transaction for the great majority of people. It is not only the largest monetary transaction in which most people engage, but also the mechanism through which they accumulate a great portion of their wealth over time. According to an April 1999 article in *Current Issues in Economics and Finance* published by the Federal Reserve Bank of New York, “. . . a large majority of households own real estate, which represents roughly two-thirds of their overall assets. The importance of housing varies over the life cycle of the individual, but real estate remains the cornerstone of most household asset portfolios.”

In many cases, real estate also serves as a means of wealth creation through increases in value and by providing real economic benefits through tax advantages. In addition, real estate serves as the underpinning for hundreds of billions of dollars in securities due to the securitization of home mortgages and other real estate loans not only for the private sector banking industry, but also for numerous government-sponsored entities, such as secondary market giants Fannie Mae and Freddie Mac.

The NAR's own 2001 *Home Wealth Effect Survey* bears this point out. According to the NAR:

- Homeowners are much more likely to have most of their wealth in their home, as opposed to stocks, bonds, and pension plans;
- The typical homeowner has unrealized *financial* gains of \$50,000 in their home; and
- Of the homeowners with unrealized gains, 16 percent have changed their spending or savings (i.e., their financial) behavior as a result, compared to 3 percent of stockholders with unrealized gains. Moreover, homeowners are able to use the value of their homes when making important financial decisions.

The Fed and Treasury, in their request for public comment, note that many of the essential aspects of real estate brokerage are already permissible under national bank “finder” authority. The regulators already authorize financial holding companies, as well as national banks and their subsidiaries, to act as finders in bringing together buyers and sellers for financial or nonfinancial transactions. Permissible finder activities include “identifying potential parties, making inquiries as to interest, introducing or arranging meetings of interested parties, and otherwise bringing parties together for a transaction...”<sup>3</sup> This description of finders authority is the essence of every real estate transaction.

---

<sup>3</sup> 12 CFR 7.1002.

Apart from their authority with respect to these three specified activities, the Fed and Treasury have broad discretion to determine that other types of activities are “financial in nature or incidental to such activity.” In making such a determination, the regulators are directed to consider a number of factors. Among the specific factors to be considered are:

- Changes or reasonably expected changes in the marketplace in which financial holding companies compete or the technology for delivering financial services; and
- Whether the proposed activity is necessary or appropriate to allow a financial holding company to –
  - Compete effectively with any company seeking to provide financial services;
  - Efficiently deliver information and services that are financial in nature through the use of technology, including applications involving systems for data transmission or financial transactions; and
  - Offer customers any available or emerging technological means for using financial services or for the document imaging of data.

The GLB Act standard is a significant expansion of the Fed and Treasury’s capacity to consider the competitive realities of our nation’s financial marketplace when determining permissible activities for financial holding companies and financial subsidiaries. It is our contention that the marketplace, and the technology associated with it, in the case of real estate brokerage and property management, have already changed and will continue to change dramatically in ways that significantly impact the ability of banks to effectively compete with other companies that provide financial services.

Finally, in addition to the newly-authorized financial activities described above, the Act authorizes financial holding companies to engage in certain nonfinancial activities. Specifically, a financial holding company may engage in a nonfinancial activity, or acquire a company engaged in a nonfinancial activity, if the Fed and Treasury determine by regulation or order that the activity: (1) is complementary to a financial activity; and (2) does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally.

The NAR would have this Subcommittee believe that Congress meant to preclude real estate activities in the GLB Act and that the legislation accomplished that goal. This is simply untrue, and we have seen no specific evidence to back up this unfounded charge. There is absolutely nothing in the legislative history to support this allegation. To the contrary, the plain language of the statute and the legislative history show the Treasury and Federal Reserve are following exactly the process and using the factors Congress intended.

The GLB Act itself demonstrates Congress's knowledge of this issue in its determination that financial subsidiaries of national banks should be prohibited only from engaging in real estate development activities – the riskier aspect of the business in which the banking organization takes an ownership position. Had Congress intended to prevent banking organizations from engaging in the agency activities of real estate brokerage and real estate management, it clearly knew how to do so. The fact that Congress chose only to prohibit real estate development leads to the conclusion that Congress did not intend to restrict agency activities.

Certainly the NAR had every opportunity to raise the issue with Congress in 1999 and either chose not to or did so without success. Rather, NAR's simplistic argument is that the proposal involves "commerce" and is, therefore, beyond the scope of the GLB Act. However, the issue is not at all that simple. The language of the relevant provisions of the GLB Act does not prohibit commercial activities; rather they set out specific criteria to determine permissible activities. The authors clearly recognized that there was no exact or permanent line to define services that should be permissible. That is why they left the determination of whether or not a given activity is financial in nature or incidental to a financial activity to the Fed and Treasury, and why they developed the specific criteria that are in the statute. To reiterate, if Congress had wanted to make such a determination to exclude the proposed activities, it would have explicitly done so – as it did with real estate development.

It is worth noting, since NAR has raised the specter of banking and commerce, that the Fed has, for many years, been the primary opponent of breaching the wall between banking and commerce. Based on this record, one would certainly expect the Fed to look very closely at any question relating to commercial activities.

The Financial Services Coordinating Council (FSCC), consisting of the ABA, the American Council of Life Insurers, the American Insurance Association, and the Securities Industry Association, supports open competition and is on record opposing H.R. 1839 and S. 1839. These members of these associations know how quickly markets change and the need for a flexible regulatory system keep markets competitive. In the letter, the FSCC states:

The fundamental purpose of the Gramm-Leach-Bliley Act (GLBA) was to develop a flexible structure for our financial system that could adjust to changes in technology and other aspects of the marketplace. Congress believed, and we agree, that such a flexible structure would increase the soundness of our financial system, promote economic growth, decrease costs, and provide consumers and businesses with more choices. Congress recognized that the legislative process is too slow to keep pace with changes in technology and the global marketplace, as demonstrated by the long history of Congressional gridlock prior to GLBA.

As the next section demonstrates, the real estate market is changing rapidly and with each passing day, the competitive imbalances increase.

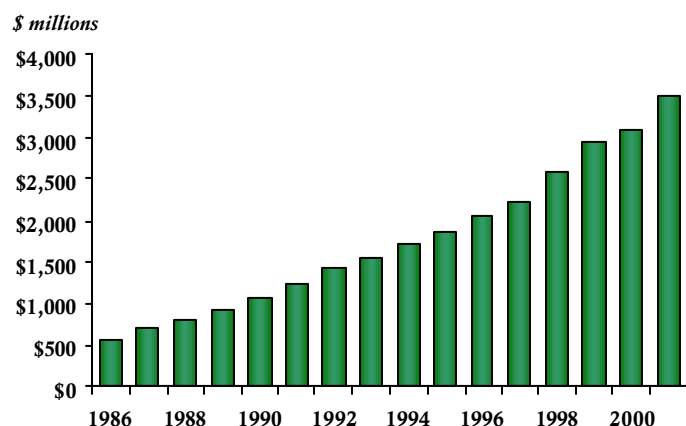
### ***The Changing Real Estate and Financial Marketplaces Require a Flexible Regulatory Approach***

As noted above, the GLB Act requires that the regulators consider competitive factors and technological innovations when determining whether activities are financial in nature. A particularly applicable statutory phrase to focus on in this context is whether the activity is “appropriate” to allow institutions to “compete effectively with any company seeking to provide financial services in the U.S.” Other types of insured depository institutions have the authority to provide – and are providing – real estate brokerage and management services. We have already demonstrated that real estate brokerage firms are providing financial services throughout the U.S. Clearly, the fact that real estate brokerage firms are offering mortgages and other financial services must be part of the regulatory consideration. Competitive imbalances like this are the very thing that Congress sought to correct when it enacted the GLB Act, and we believe that the use of the flexibility granted to the regulators under Section 103 (a) is clearly justified in the case of real estate brokerage and management authority for banking organizations.

Technological innovations have also had a dramatic impact on real estate markets. One major change is the development of the secondary market for mortgage loans and the efficient process that bundles individual home loans into highly liquid, globally-traded securities (see Chart 3).

Chart 3

### Mortgage Backed Securities Outstanding



Source: Federal Reserve

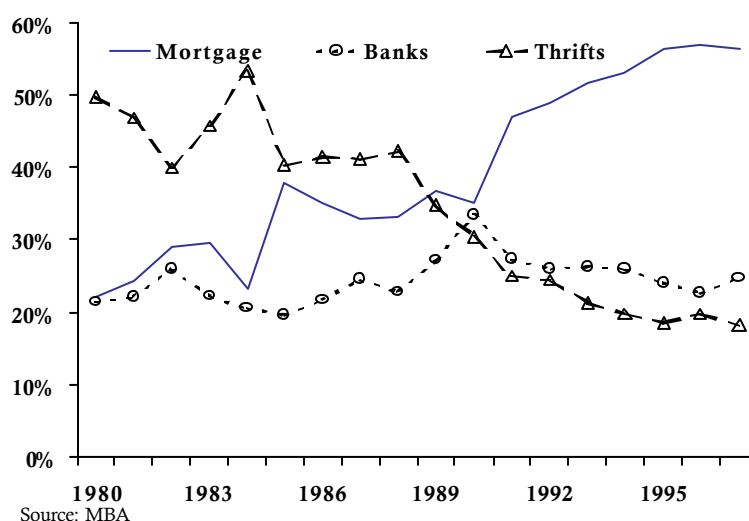
The increasing importance of the secondary market has facilitated the rapid growth of mortgage lending outside traditional banking and savings institutions (see Chart 4).

In fact, securitization has significantly changed the very nature of mortgage funding, enabling real estate firms to establish their own mortgage companies and to offer end-to-end real

estate transactions – helping a buyer find a home, finance it, and insure it. The result is that traditional deposit-based lenders – banks and thrifts – are often bypassed completely. These are exactly the kinds of technological changes the GLB Act authorized the Treasury and the Fed to address.

Chart 4

### Mortgage Originations



Source: MBA

The dominance of the secondary market is clear evidence that this form of funding for plain vanilla mortgage loans is generally superior in terms of costs to funding with bank deposits. If banks somehow enjoyed some special benefit from deposits, or deposit insurance (which banks pay for through premiums and extensive regulatory costs), banks would not be selling into the secondary market,

and the secondary market would not control an ever-increasing share of the marketplace. No amount of deposit insurance can counteract this fundamental principle of efficient markets. More importantly, access to this secondary market source of funding is available equally to mortgage and banking organizations, and is clearly why real estate companies increasingly are affiliating with mortgage banking companies.

To summarize this section, the GLB Act recognized that achieving the goal of promoting competition necessarily required regulatory flexibility. Section 103 (a) provides that flexibility by authorizing the Fed and the Treasury, subject to certain statutory guidelines, to approve additional activities for banking organizations. The ABA believes strongly that real estate brokerage and management meet the criteria. Of course, the Fed and Treasury have not made any determination on this proposal. Regardless of their ultimate decision, the Fed and Treasury should be allowed to follow the process Congress created only two-and-a-half years ago.

### **III. All Consumer Protections Are Maintained and Bank Safety and Soundness Is Protected**

If banking organizations offer real estate services, consumers would actually have more protections under the law than they do today. ***All rules applicable to real estate brokers, including all state licensing, qualification and sales practices will apply equally to bank-affiliated real estate agents.***

NAR has raised the specter of customers being taken advantage of as a result of conflicts of interest that may potentially arise when a real estate broker is affiliated with a lender. The simple fact is that the exact same potential for such abuse occurs, for example, each time an agent from Century 21, Coldwell Banker, ERA (all of whom are affiliated with Cendant) GMAC, Long & Foster or USAA helps a customer buy or sell a house. And yet, although these integrated real estate organizations, as well as state banks in many states, savings institutions, and credit unions, have been selling real estate and funding mortgages for years, there has been no outcry about these conflicts of

interest. Why? — Because the Real Estate Settlement Procedures Act (“RESPA”)<sup>4</sup> requires realtors affiliated with lenders to disclose that fact to customers before the purchase occurs.

The RESPA disclosure,<sup>5</sup> which must be on a separate piece of paper, must state the relationship between the real estate agent and the lender and provide the estimated charges or range of charges of the lender. It must also notify the customer that he or she is *not* required to use the lender and is free to shop around for a better deal. If the real estate agent requires the use of its affiliated lender, that agent violates the kickback and unearned fee provisions of Section 8 of RESPA. The customer is expected to sign an acknowledgement of the disclosure.

In addition, consumers have even more protections when their real estate agent *is* affiliated with a banking organization. This is because banks and bank holding companies and their subsidiaries and affiliates are subject to the anti-tying provisions of the Bank Holding Company Act.<sup>6</sup> These restrictions prohibit banks and their affiliates from conditioning the provision of credit on the purchase of another product or service.

Another false impression put forward by NAR is that somehow bank involvement is contrary to the spirit of the Community Reinvestment Act. Nothing could be further from the truth. Approval of the proposal would help low income and minority communities. Because banks are subject to CRA, they would have every incentive to use their real estate authorities to enhance their outreach to communities. The bank would bring real estate services to areas now shortchanged and could use the combination of real estate and financial services to better serve their low-income and minority communities. Moreover, if the real estate unit were a subsidiary of a national bank, that subsidiary would be covered by CRA.

---

<sup>4</sup> 12 U.S.C. § 2601 *et seq*

<sup>5</sup> The requirement for affiliated business disclosures is part of the regulations of the Department of Housing and Urban Development that implement RESPA. 24 C.F.R. § 3500.15.

<sup>6</sup> Section 106(b) of the Bank Holding Company Act Amendments of 1970.



Bank involvement in real estate brokerage and management services is also consistent with safe and sound banking. First, providing these services will help to diversify the income stream of these institutions and help to improve their financial base. Real estate brokerage and management services are activities where a bank acts only as an agent for a third party, ***but does not take an ownership position in the property***. By their very nature, agency activities pose very little risk to the safety and soundness of depository institutions.

Second, under the GLB Act, the bank regulators must deem a banking organization to be well-capitalized and well-managed before it can participate in any of the expanded financial activities permitted under the GLB Act, including real estate brokerage and property management. Thus, only financially strong institutions would be authorized to engage in these activities.

Third, banking organizations are also subject to Sections 23A and 23B of the Federal Reserve Act, which limit the amount of credit and other forms of support that a bank could provide to a real estate brokerage affiliate or subsidiary. Such limits ensure that the safety and soundness of the bank will not be negatively impacted by its subsidiaries or affiliates.

Fourth, many banking organizations already have years of experience in providing real estate activities. In fact, the purchase, sale and management of real estate are frequently significant aspects of fiduciary asset management in many bank trust departments. Because banks currently have trust personnel who provide real estate brokerage and management services on a daily basis to trust customers, providing the service outside of the trust department would not be a new activity in which banking organizations lack expertise. Thus, no new safety and soundness issues would be raised.

Finally, it is important to note that a precedent already exists for bank involvement in real estate activities. In over half of the states, state banking regulators have the authority (either explicitly, through regulatory interpretations, and through wildcard and parity statutes) to allow state-chartered banking organizations to engage in real estate activities (see the attached state-by-state listing developed by the Conference of State Bank Supervisors). Moreover, savings institutions

and credit unions already have brokerage authority. Allowing banks the same rights and privileges should enhance the competition for real estate services.

## Conclusion

In July, it will be two years since the filing of the original petition requesting a determination that real estate brokerage and management be deemed financial in nature. It is now certain that this determination will not be made until 2003, as was indicated in an April 22, 2002 letter from Treasury Secretary Paul H. O'Neill to Congressman Michael G. Oxley, indicating that, in consultation with the Fed, the Treasury will not make a final decision on this proposed rule until next year.

A fundamental purpose of the GLB Act was to enable banking institutions to compete with other financial services providers, and there is ample evidence demonstrating that the real estate competition is touting the advantages of one-stop homebuying services. While we as an industry have always looked at real estate brokerage and management as providing us with more options to compete in the long term, with *each passing day*, real estate firms become more deeply involved in financial services such as mortgage and insurance, and banks like mine cannot effectively compete for this business. And with each passing day, the case for allowing banks to offer real estate services only gets stronger.

As an industry we have grave concerns about the broader effects of this controversy and whether it sets a precedent that could hinder future approvals of new powers under GLB. The Act was designed to keep our financial system up-to-date by delegating those decisions to the Fed and Treasury. This goal is being frustrated by efforts to take the case for determining what is appropriate back to Congress, placing Congress in the very role that it delegated to the agencies with the greatest level of expertise to make these decisions based on specific statutory criteria.

H.R. 3424 not only frustrates the GLB Act process, it reduces consumer choice. Consumers would have fewer choices of whom to do business with; agents would have fewer choices of whom to work for; and businesses would have fewer choices for joint marketing, fewer potential merger

partners, and fewer potential buyers. We believe a competitive market is the best way to provide quality real estate brokerage and management services. Increased competition clearly benefits consumers and the economy. It is a catalyst for innovation, more customer choice, better service, and competitive prices. I have no doubt that my customers and my community would benefit if my small bank could offer these services.

In this new, competitive environment, bankers and real estate professionals have much to offer to each other – and to consumers. Real estate professionals could provide the personalized services and experience that is their strength. Independent agents who provide good service today know that they will be competitive with *anyone*, whether the competitor is another independent agent or one affiliated with a bank.

Many real estate companies realize the strengths that both industries bring to the table. Banks like mine could provide needed capital, cross-marketing opportunities, and technology to support the growth of local real estate firms. Real estate firms also realize the severe limitations H.R. 3424 would impose on their ability to joint market, merge, be acquired, or even to buy a bank.

Not only would consumers benefit from bank involvement in real estate services, but also bank involvement is consistent with safe and sound banking. All consumer protections that apply to independent realtors would apply to bank-affiliated real estate agents – plus bank-affiliated agents would be subject to additional anti-tying regulations. And because brokerage and management are agency activities, they pose no financial risk to the safety and soundness of the banking organization.

Just two-and-a-half years ago Congress made the decision to leave this type of determination to the regulators – so that they could keep the financial structure up-to-date and keep Congress out of the middle of competitive disputes. NAR now wants to put Congress back in the uncomfortable position of referee. Congress explicitly gave the Fed and Treasury the flexibility and authority to make these determinations based on their expert knowledge of the changes in the financial services marketplace. Those agencies should be allowed to carry out the authority that Congress wisely provided to them.

I thank you, Mr. Chairman, for this opportunity to present the views of the American Bankers Association.